Consultation on the Draft UK- Ireland Reference Period 2 Performance Plan

Paper by the Chair of Trustees, NATS Employee Sharetrust Ltd

The CAA has sought comments by 4th April on the draft UK/ Ireland Performance Plan for Reference Period 2. As trustees of the NATS All Employee Share Ownership Plan, we wish to comment on the statement made in the CAA's consultation document (paragraph 6.32 et seq) that the operation of the NATS share plan is "anomalous", that the net costs of the scheme should be absorbed by shareholders or out of the overall staff remuneration allowance, and that the CAA is proposing to exclude this element of cost from the plan.

We wish to register our considerable dismay at this proposal.

When the NATS PPP was established in 2001, the Government was concerned to ensure, as a matter of policy, that staff played a significant role in the new ownership structure of the company. Therefore, the Government and the Airline Group established a trust, approved by HM Revenue and Customs, to hold the 5% of NATS shares reserved for the benefit of employees. The shares are made available to all employees in NATS on an equal basis without regard to their position in the company, in accordance with the terms set out in the trust deed and rules. The CAA has continued to support the operation of the share plan through all regulatory settlements until now.

The purpose of the share plan is to align employee, shareholder and also customer interests. Encouraging better performance and efficiency in this way clearly benefits NATS' customers, as demonstrated in the improvements in the company's service performance since 2001. If the company prospers through the efforts of its employees this is reflected in the share price; if the company performs poorly this too would be reflected in the price. The Coalition Government has expressed its own strong support for the principle of employee share ownership as evidenced in the decision to establish similar arrangements as part of the recent sale of Royal Mail.

Under the constitutional rules put in place for the NATS PPP in 2001, there is no market for NATS employee shares except between the employee and the Trust. The shares cannot be sold out of the company, they cannot be traded between staff, nor can they be retained after staff have retired. The trustees have no external income and are therefore reliant on the company to help meet the costs of the scheme as they fall due. This was an intrinsic part of the design when the PPP was established.

For the first years of the PPP, employee shares were issued as free shares, at the Government's instigation. Having met the objective of awarding the 5%, the company moved to a lower cost approach to awards whilst seeking to continue to incentivise staff participation in the scheme. Now, and since 2010, all share offers are made on a "buy one get one free" basis at the prevailing market value as determined by independent valuation. This ratio is lower than the "buy one get two free" ratio permitted by HM Revenue and Customs and by the terms of the trust.

The CAA is recommending that NATS should be incentivised to end this matching arrangement. However, this arrangement is standard practice throughout UK industry for this type of HMRC approved share plan as a means of incentivising staff. Examples of offers made in other companies include:

- Lloyds Banking Group which offers matching shares at a ratio of one for one;
- First Group which offers matching shares at a ration of two for three; and
- Aviva offer which offers matching shares at a ratio of two for one.

There is a significant risk that the CAA's proposal to discontinue the allowance for funding will undermine the company's continued commitment to the plan. The cost of share awards made to date cannot be avoided and requires to be financed. For the CAA to decide that commitments already made to employees should be excluded from the regulatory settlement would be totally unacceptable and is not a reasonable position to take. The CAA has not previously indicated a change in approach in this area and trustees have therefore acted in good faith in making commitments to staff through shares awarded under the scheme in Reference Period 1 and prior years. Staff will rightly expect that the terms on which the awards were made will be honoured by trustees and funded by the company.

For the CAA to decide that future commitments should be excluded is also unacceptable and is not a reasonable position to take. The NATS Board has to approve all share awards and, if the CAA decided to deny funding for the share plan, the Board has it within its power to simply put the plan into abeyance and not authorise any further awards. In such circumstances, the effect of a CAA decision to deny funding would have no meaningful impact on the major shareholders or the company but would deprive NATS employees of an important benefit that they were promised by Government when the PPP was established. Trustees are thus concerned that the burden of the CAA's measures will fall solely on staff. This cost is not related to equity, as CAA suggests. Also, we do not believe that undermining long established employee terms and conditions of service in this way will be of benefit to customers.

The consultation document notes in relation to staff costs generally (paragraph 6.25) that the CAA is not proposing to impose any cap on pay and that it is not for the regulator to micro manage the NERL business. Yet this is precisely what the CAA is proposing in respect of the employee share plan. If the CAA were to curtail the revenue allowance for employee shares then clearly it is putting the business under pressure to change its approach; indeed the operation of the plan is explicitly described in the consultation document as "anomalous". Employees will quite reasonably see this overt pressure as a form of micro management by the CAA.

Employees who have been in post for the 13 years since the start of the PPP, who have acquired the maximum number of shares at each offer, and who have never sold any of their shares now have 2777 shares of which 400 Partnership shares have been paid for out of their own income. Therefore, over this 13 year period, the total value of their holding, excluding the shares they have already paid for themselves, averages out to around £870 per annum. This is hardly a princely reward for 13 years of continuous saving in the share plan, particularly in view of the real benefits to customers in terms of staff motivation.

In practice, very few employees have the maximum shareholding either because they joined NATS subsequent to the PPP or because they have already sold some of their shares. The average holding per employee is currently 1425 shares, of which 400 shares have been paid for out of income. Excluding these paid for shares, the average holding per employee in NERL is currently valued at £4612. The shares have to be held in the Plan for five years before their full value can be realised and in some circumstances can be forfeited if certain conditions are not met.

The stated £3 million cost of the scheme is around half a per cent of NERL's total running costs and is not "very high". The cost represents the company's forecast of the increase in obligation each year over RP2. The forecast follows the rules of international accounting standards and spreads the cost of the scheme over the period of employee service. In practice, the income and capital gains tax benefits of holding shares in the trust provide a strong incentive for staff to hold on to their shares for the long term and not to sell them at the earliest opportunity. The actual cash funding requirement in RP2 may be different and volatile, but this cannot be forecast. For this reason the company applies international accounting standards in its projections to smooth costs.

One final point is that the share plan is operated as a NATS-wide scheme and, while three quarters of NATS staff are within NERL, the other quarter are employed by NSL in the unregulated business. While NSL staff are outside the scope of the CAA's review, any decision to deny funding to NERL would necessarily lead the NATS Board to review the operation of the scheme as a whole as the trust deed requires all NATS staff to be treated equally. The proposals would therefore impact staff outside the regulated business and this is clearly inappropriate.

To summarise, we urge the CAA to continue to support the principle of employee share ownership and to facilitate the continued operation of the NATS employee share plan as an integral part of the PPP structure.

Baroness Brenda Dean of Thornton-le-Fylde
Chair, NATS Employee Sharetrust Ltd

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